

ROBERT FEINSCHREIBER

Attorney at Law
1121 Crandon Blvd. Suite F-301
Key Biscayne, FL 33149
Phone 305-361-5800 Fax 305-361-7722

May 27, 1997

Mr. Paull Mines, General Counsel
The Multistate Tax Commission
444 North Capital Street, NW Suite 425
Washington, D.C. 20001

tel: 202-624-8699
fax: 202-624-8819

Dear Paull,

We are pleased to enclose our views concerning the Initial Public Working Group Draft of the Constitutional Nexus Guideline for Application of the State's Sales and Use Tax to an Out-of-State Business. These views are of first impression only; we have made no attempt at this juncture to reflect case law developments.

As you can see below, we believe that the Guidelines overreach Constitutional requirements as to advertising, independent contractors, the storage of business records, and similar issues. Nevertheless, we believe that the MTC could take stronger positions could as to consignment sales and contract carriers. We look forward to discussing these issues with you in Dallas on June 16-18. We welcome your comments and will be in Miami until Saturday, May 31.

Preliminary Issues

The conclusion of the Preliminary Comments, 1D, *Limitation of application of Guideline* states that "Determination of state statutory nexus is the province of the state legislature." I would add to this provision the following phase: "but may be subject to U.S. Constitutional provisions and by federal legislation."

Constitutional Issues

The first paragraph of II, *Due Process and the Commerce Clause define nexus*, refers only to the Due Process Clause and the Commerce Clause. However, other clauses in the U.S. Constitution, including the Foreign Commerce Clause, may be applicable in determining nexus.

Minimum Contact Nexus

II. A., *Due Process Clause Nexus*, in defining "minimum contact nexus" refers to the "quality and quantity of the contacts" and to "notions of fairness and substantial justice." We believe that these two standards properly enunciate Constitutional due process standards. Nevertheless, specific provisions in the Guideline deviate from this due process objectives in a number of instances which are discussed below.

"Due process nexus," in the context of state taxation, parallels tort long-arm jurisdiction. For example, a motorist who causes damage to persons or property outside the state is subject to judicial process outside the motorist's residence. A taxpayer that engages in business outside its residence is subject to the taxation process in states in which the taxpayer does business. Such tort claims are self-limiting, however, as the claim must be reviewed by the parties in the context of costs and expenses, especially the plaintiff, as well as the possibility of sanctions by the courts against the parties for frivolous claims. The tax collector does not have comparable expenses in pursuing the out of state entity.

II.A.1., pertaining to sales tax, and II.A.2., pertaining to use tax, make no reference to the "quality or quantity of the contacts" as enunciated in II. A. As a result, there is a danger to the taxpayer that any sale or group of sales, regardless of how small or how infrequent, could be viewed by a tax collector as taxable. The MTC would vitiate the safeguards that would apply in the tort context, as described above, as they would not apply in this instance. We suggest that the applicable standard is reflected in II.A.3.b, and II.A.3.c., which refers to "the magnitude of the contacts." That same standard should apply to sales and use tax. Accordingly, II.A.1 and II.A.2 should be abandoned, as should II.B.1. and II.B.2., which pertain to *Commerce Clause Nexus*.

"Occurs in the Taxing State"

In a separate matter, the phrase "occurs in the taxing state" in II.A.1. should be defined in F, if this provision is to be carried forward in the Guidelines. In essence, the place of sale should be addressed, whether the sale is determined by destination or by title passage. Perhaps the MTC should develop a conflict of law rule to determine the place of sale. We

suggest that the MTC seek uniformity as to the place of sale. In the present situation, the described transactions might not be substantial.

De minimis

II.A.3.a. and II.B.3.a., pertaining to the *de minimis* rules, would impose an impossible burden of proof upon the taxpayer. The MTC Guideline would require the taxpayer to prove a negative. It might be more equitable for a taxing state to demonstrate that the out-of-state-business is itself "viable," "a separate entity," or is "an integral part of a unitary entity."

Business Connection

The "business connection" test in II.B.3.b. should be defined in F. We suggest that business connection should in any event be limited to exclude communication connections of all types.

Territorial Assignments

Example 3 to II.C.1. *Concept of physical presence in the Taxing State* would treat travel on an occasional basis as connoting nexus. Here the salesperson is assigned to this territory by the Corporation employing the individual. F.7. defines "occasional" as "occurring at infrequent and irregular intervals." The presence of a territorial assignment should be a factor to be considered in determining physical presence, but the territorial assignment should not be determinative of the issue of physical presence. See Example 4 to II.D.1.b. concerning assigned territory in the context of the *de minimis* rule, which also appears to be equally invalid. Further, the Guidelines should define the term "depending on market conditions."

Infrequent and occasional activities in the state should be viewed as being below the threshold to create nexus. If a corporation hires an employee to travel to two states, spending 150 days in each, the corporation presumably should be subject to sales tax in each of the two states. However, if a corporation hires an employee to travel among 40 states, for example, spending five days in each during the year, in average, such a corporation should not be subject to sales tax in each of these 40 states.

Example 4 to II.C.1 should be revised accordingly. Similarly, Example 4 in II.D.1.b. is overreaching as to nexus for hiring an independent contractor for two days during the year. See Example 3 to II.C.1. as to territorial assignment. Again, a territorial assignment is relevant but should not be determinative.

As a definitional matter, "not permanent" on line 148, in reference to an employer's presence in the state, should be defined differently than "occasional" or "temporary."

Telecommuting

Example 6 to II.C.1 pertains to telecommuting activities. It is essential that the MTC define these activities. In context, it appears that "telecommuting" consists of production activities, such as developing software, or sales activities. Causing the company to be subject to taxation because of telecommuters may be appropriate if the telecommuting is pervasive, regular, and full-time, but not if telecommuting is sporadic, irregular, or part-time. The MTC is attempting to apply a "hard and fast" rule that appears to exceed Constitutional authority.

Correlation

Example 1 to II.C.2. pertains to leasing or maintaining real property. The result in Example 1 appears to correct, but should be restated to correlate with state income taxation: "Physical presence applies for purposes of the sales tax whether the income generating the property is subject to apportionment or is allocated for income tax purposes."

Advertising

Example 2 to II.C.2 pertains to advertising as creating nexus. The Guideline appears to exceed what is intended. Consider the leasing of billboards, for example. The example would put billboards in a worse situation than the print media or telecommunications. Carried to an extreme, consider a company that leased a billboard on a train. Taken literally, the MTC would impose sales taxation on each state in which the train travels. See Example 4 to II.C.3. for similar advertising issues, advertising by airplane, which would extend nexus beyond what is intended. In fact, the Guideline would impose sales taxation based on three hour time period, the duration of the game.

Carried to an even further extreme, the Guideline would impose sales taxation on a company having a uniformed employee in the state, regardless of the time spent in the state. Also, carried to an extreme, the Guideline would seek to impose sales taxation on any company represented at a trade fair in the state. As a further example, the distribution of free t-shirts for advertising purposes, standing by itself, would subject the company to sales taxation in the state. Accordingly, the Guideline exceeds Constitutional limitations.

Consignment Sales and Security Interests

Example 1 to II.C.3. pertains to tangible property in the taxing state. This example provides nexus because of a consignment of tangible personal property to unrelated persons in accordance with its normal business practice. The phrase "normal business practice" is unnecessary; consignment should connote nexus whether or not it is unusual, excluding only property removed from one state to another state for emergency purposes, such as fire, flood, or other natural disaster. The deliberate use of consignment merchandise should create nexus for sales tax purposes and for inclusion in the property factor for state income tax purposes.

In contrast, Example 2 to II.C.3 pertains to security interests. Security interests in property should be excluded from nexus if the sale of property was excluded from the ambit of sales taxation. Similarly, see II.D. 1.b. Example 1 pertaining to security interests. A sale on credit is a sale nonetheless, and the presence of a secured sale in and of itself should not create nexus. The MTC rule would put sellers who sell to creditors in a worse position than sellers that sell for cash. In essence, the MTC position favors rich purchasers against poor purchasers, and such policy should be discontinued. Similarly, Example 5 to II.D.1.b. should be eliminated.

Storing of Business Records

The storing of business records should not determine nexus. In fact, it is questionable whether the storing of records should be an indicia of nexus. If nothing else, the First Amendment should preclude the treatment sought by Example 6 to II.C.3. A company may disseminate all or part of its records for many purposes, including to a variety of boutique law and accounting firms. At an extreme, the storing of records could include maintenance of a computer disk. Treating the storage of records as nexus in such situations would a disservice.

Warranties

Implementation of Example 1 to II.C.5 would cause the deterioration of goods and services in the state that seeks to impose taxation on the basis of warranting goods. In essence, warranty services are not "significantly associated" with the underlying activity. Businesses seeking to avoid undesired nexus might choose to forego warranty services instead.

Contract Carriers

Although recent case law did not impose nexus for a company using a contract carrier, a contract carrier takes the place of an employee of the manufacturer or distributor. Accordingly, the hiring of a

contact carrier should cause nexus in the state in which the contract carrier travels in the ordinary course of business. In essence, the carrier serves as *alter ego* to the manufacturer or distributor. The contract carrier serves as employee, not an independent contractor or common carrier. The carrier itself puts residents at risk because of automobile accidents, slip and fall risks, and other risks, thus substantiating nexus. The contact carrier and its contractor may both be liable in tort in that situation. See Example 2 to II.C.5.

This initial analysis may be subjected to further revision.

Very truly yours,


Robert Feinschreiber


Margaret Kent